# *Summary of the 1997 Annual Social Security and Medicare Trust Fund Reports*

## *The Board of Trustees*

There are six Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two members appointed by the President and confirmed by the Senate to represent the public. Currently, the Public Trustees are Marilyn Moon, an economist who has written extensively on Medicare, and Stephen G. Kellison, an actuary who has taught and consulted widely on social insurance. All Trustees serve on the Boards of all of the trust funds described below.

## *Trust Funds*

The trust funds are accounts in the U.S. Treasury. Social Security and Medicare taxes, premiums, and other income are deposited in these accounts, and Social Security and Medicare benefits are paid from them. The only purposes for which these trust funds can be used are to pay benefits and program administrative costs.

The trust funds hold money not needed to pay benefits and administrative costs and, by law, invest it in special Treasury bonds that are guaranteed by the U.S. Government. A market rate of interest is paid to the trust funds on the bonds they hold, and when those bonds reach maturity or are needed to pay benefits, the Treasury redeems them.

There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits. (The two trust funds are described together as OASDI.)

For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care, and the Supplementary Medical Insurance (SMI) Trust Fund pays for physician and outpatient services. Medicare benefits are provided to most people age 65 or older and to workers who are receiving Social Security disability benefits.

## *Trust Fund Results*

In December 1996, almost 38 million persons were receiving OASI benefits, just over 6 million were receiving DI benefits, and about 38 million people were covered under Medicare. Trust fund operations, in billions of dollars, are shown in table 1 (totals may not add due to rounding).

## *How the Trust Funds Are Financed*

For Social Security and the Hospital Insurance part of Medicare, the major source of financing is payroll taxes on earnings that are paid by employees and their employers, and by the self-employed. Persons who are self-employed are charged the equivalent of the combined employer and employee tax rates. In 1996, $489 billion (89 percent) of total OASI, DI, and HI income came from payroll taxes. The remainder was provided primarily by interest earnings ($49 billion or 9 percent) and revenue from taxation of OASDI benefits ($11 billion or 2 percent).

The payroll tax rates are set by law and for OASI and DI apply to earnings up to a certain annual amount. This amount, called the earnings base, rises as average wages increase. In 1997, the earnings base for OASDI is $65,400. HI taxes are paid on total earnings. The tax rates for employees and employers each under current law are shown in table 2.

The Supplementary Medical Insurance part of Medicare is financed by monthly premiums charged beneficiaries ($43.80 in 1997) and by payments from Federal general revenues. In 1996, premiums accounted for almost $19 billion (22 percent) of SMI income and interest income was about $1 .8 billion (2 percent). The remainder, $65 billion (76 percent), consisted of general revenue payments. Chart 1 shows sources of income in 1996 for OASDI and HI combined and for SMI.

Table 1 .-Trust fund operations, calendar year 1996 [1]

[In billions]

| Item | OASI | DI | HI | SMI |
|---|---|---|---|---|
| Assets (end of 1995) | $458.5 | $37.6 | $130.3 | $13.1 |
| Income during 1996 | 363.7 | 60.7 | 124.6 | 85.6 |
| Outgo during 1996 | 308.2 | 45.4 | 129.9 | 70.4 |
| Net increase in assets | 55.5 | 15.4 | -5.3 | 15.2 |
| Assets (end of 1996) | 514 | 52.9 | 124.9 | 28.3 |

[1] Totals may not add due to rounding.

## *Administrative Expenses*

Administrative expenses in 1996, shown as a percentage of benefit payments from each trust fund were:

| Program | Percent |
|---|---|
| OASI | 0.6 |
| DI | 2.6 |
| HI | 1.0 |
| SMI | 2.6 |

## *How Estimates of the Trust Fund Balances Are Made*

Short-range (1 O-year) and long-range (75-year) estimates are reported for all funds. These estimates are based on assumptions about all of the factors that affect the income and outgo of each trust fund. They include economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as specific factors relating to disability incidence and the cost of hospital and medical services.

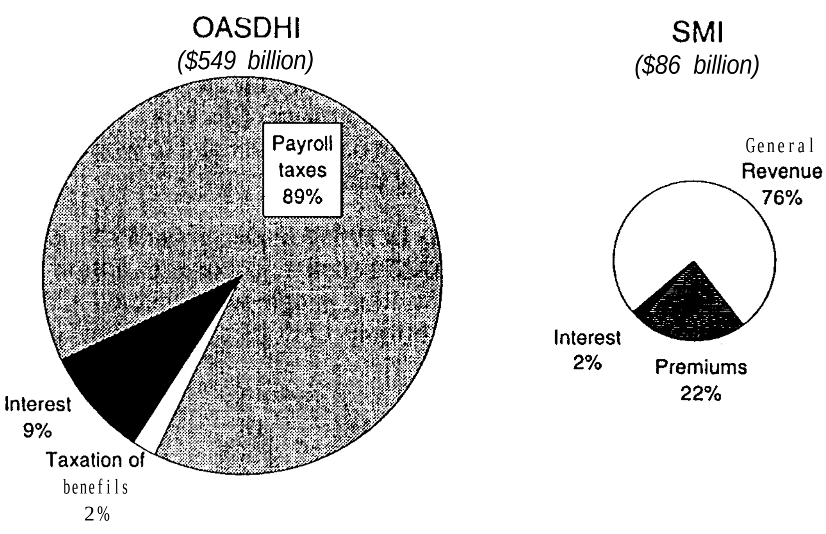
Because the future cannot be predicted with certainty, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions (alternative II) reflect the Trustees' best estimate of future experience. The low-cost alternative I is more optimistic for trust fund financing, and the high-cost alternative III is more pessimistic; they show trust fund projections if economic and demographic conditions are more or less favorable than the best estimate.

The assumptions are re-examined each year in light of recent experience and new information about future trends, and are revised if warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. While estimates of income and expenditures usually have been close to actual experience, any estimates for as long as 75 years into the future are inherently uncertain. Nonetheless, careful review and updating on an annual basis provides an indication of the range of future possibilities.

Table 2.—Tax rates for employees and employers, each

| Calendar year | Total | OASDI | OASI | DI | HI |
|---|---|---|---|---|---|
| 1997-99 | 7.65 | 6.20 | 5.35 | 0.85 | 1.45 |
| 2000 and later | 7.65 | 6.20 | 5.30 | .90 | 1.45 |

Chart 1 .-Sources of income to trust funds in 1996




## *The Short-Range Outlook (1997-2006)*

For the short range, the adequacy of the trust funds is measured by comparing their assets at the beginning of a year to projected benefit payments for that year (the "trust fund ratio"). A trust fund ratio of 100 percent-that is, assets at the beginning of a year at least equal to projected benefit payments for that year-is considered a good test of a trust fund's short-term adequacy. This level of assets means that even if no income were received for a year, the trust fund could pay full benefits, thereby allowing time for legislative action to restore financial adequacy.

By this measure, the OASI and DI funds are considered financially adequate throughout the next decade. The OASI and DI Trust Fund assets are over the 100 percent level through the year 2006. However, the trust fund ratio for HI is below 100 percent at the beginning of the 1 O-year period and declines rapidly. Under the intermediate assumptions, the HI fund is exhausted in the year 2001. Chart 2 shows the OASI, DI, and HI Trust Fund ratios under the intermediate assumptions.

A less stringent asset test applies to SMI, but only because its financing-beneficiary premiums and Federal general revenue payments-is automatically adjusted each year to meet expected costs.

Table 3 shows, in dollars, the projected income and outgo, and the change in the balance of each trust fund over the next 10 years.

## *The Long-Range Outlook (1997-2071)*

Over the long term, neither the OASI, the DI, nor the HI Trust Fund is projected to be in balance. Chart 3 compares, under the intermediate assumptions, the trends over the next 75 years in income and costs of these funds.

In chart 3, the long-range income and cost of OASI, DI, and HI are measured in percentage of taxable payroll rather than in dollars because the value of a dollar changes over time. (Taxable payroll is the portion of total wages and self-employment earnings that is taxed under the OASDI and HI programs.) Over the 75-year period, the income rates for OASI, DI, and HI remain relatively constant, while the cost rates rise substantially.

For OASI, the income rate is projected to remain above the cost rate for 17 years. Starting in about 20 10, however, the OASI cost rate will begin increasing rapidly as the leading edge of the baby boom generation reaches retirement age. In 20 14 and later, the cost rate for OASI will exceed the income rate by generally growing amounts-by the end of the 75-year projection period the cost rate for OASI will be almost 1% times as large as the income rate.

The income rate for DI is higher than the cost rate only through 2003, after which the annual shortfall of tax income is projected to increase slowly over the 75-year period.

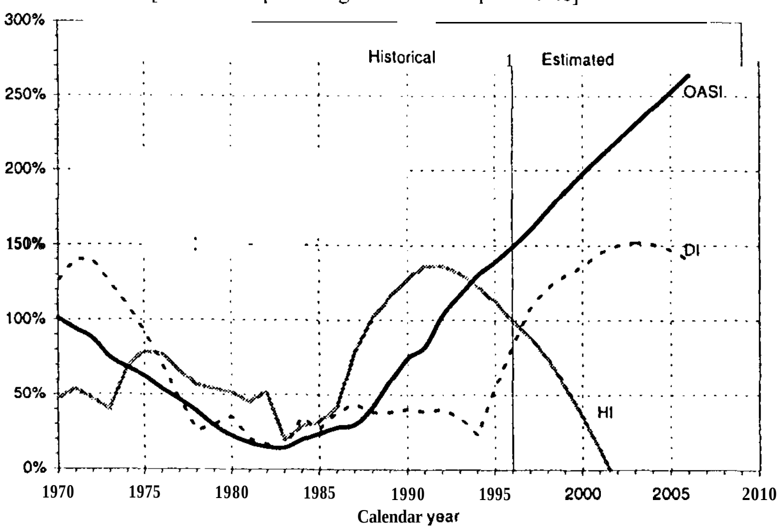
The cost rate for HI is higher than the income rate by rapidly growing amounts throughout the projection period-by 207 1, the HI cost rate is projected to be almost 3% times as large as the HI income rate.

The income rates for OASI. DI, and HI remain relatively constant in chart 3 because the payroll tax rates for the programs are not scheduled to change (except for a small shift from OASI to DI in 2000). Income from taxation of benefits will rise gradually, primarily because a greater proportion of beneficiaries will become subject to taxation in future years, and this accounts for the slight upward trend in the income lines.

The cost rates increase much more rapidly, especially for OASI and HI. The cost rate for OASI rises slowly for about 15 years, increases rapidly for about the next 20 years, and then grows more moderately. The cost rate for HI increases throughout the 75-year period.

Chart 2.—OASI, DI, and HI Trust Fund ratios

[Assets as a percentage of annual expenditures]




## *Why Costs Rise Faster Than Income*

The primary reason that the OASI cost rate increases more steeply after 20 10 is that the number of persons receiving benefits will increase rapidly as the baby boom generation retires, while the number of workers paying payroll taxes grows more slowly. The HI cost rate increases not only because of growth in the number of beneficiaries per worker, but also because of increases in both the use and cost of health care per person. Chart 4 shows the number of workers per

Table 3.-Estimated operations of trust funds'

[In billions of dollars]

| Year | Income | | | | Expenditures | | | | Change in fund | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | OASI | DI | HI | SMI | OASI | DI | HI | SMI | OASI | DI | HI | SMI |
| 1997 | $392 | $60 | $127 | $81 | $322 | $49 | $140 | $77 | 70 | 11 | -13 | 4 |
| 1998 | 409 | 62 | 131 | 85 | 337 | 52 | 152 | 85 | 72 | 10 | -20 | 0 |
| 1999 | 430 | 65 | 135 | 94 | 353 | 56 | 164 | 93 | 77 | 9 | -29 | 1 |
| 2000 | 450 | 72 | 140 | 103 | 370 | 60 | 178 | 102 | 80 | 12 | -38 | 1 |
| 2001 | 476 | 77 | 144 | 113 | 389 | 65 | 193 | 112 | 87 | 12 | -49 | 1 |
| 2002 | 503 | 81 | 148 | 124 | 409 | 70 | 209 | 124 | 93 | 10 | -61 | 1 |
| 2003 | 531 | 85 | 152 | 137 | 430 | 76 | 226 | 136 | 101 | 9 | -74 | 1 |
| 2004 | 562 | 90 | 155 | 151 | 453 | 83 | 244 | 150 | 109 | 7 | -89 | 1 |
| 2005 | 595 | 95 | 159 | 168 | 476 | 90 | 263 | 166 | 119 | 5 | -104 | 3 |
| 2006 | 629 | 99 | 162 | 188 | 501 | 97 | 283 | 184 | 128 | 2 | -121 | 4 |

'Totals may not add due to rounding.

OASDI beneficiary over the 75-year period. (The ratio of workers to HI beneficiaries is similar.)

In addition to demographic changes, the other major factor in the long-range financing of OASDI and HI is the rate of increase in the wages on which workers pay Social Security and Medicare taxes. The rate of increase in workers' wages in turn depends on how workers are able to combine their skills and work tools to increase the amount they can produce. Thus, increases in workers' productivity can help offset some of the decline in the number of workers per beneficiary.

## *The Long-Range Actuarial Balance*

Another useful way to view the outlook of the trust funds is in terms of their long-range actuarial balances over the whole

Chart 3 .-income and cost rates

[Percentage of taxable payroll]

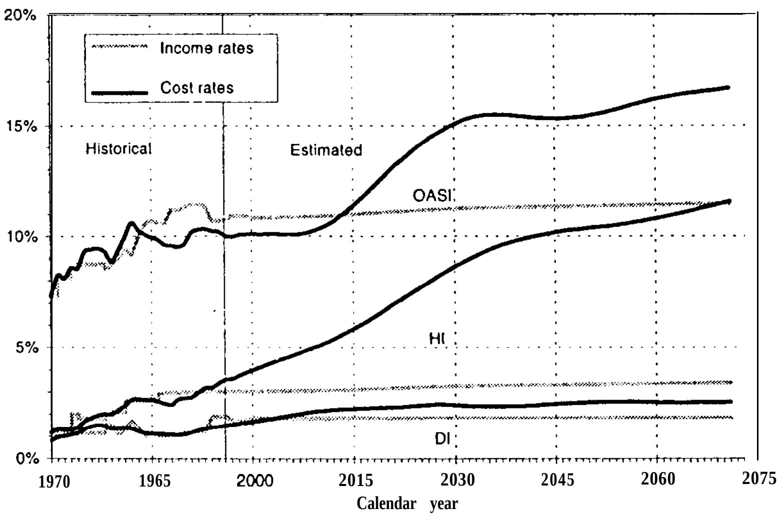
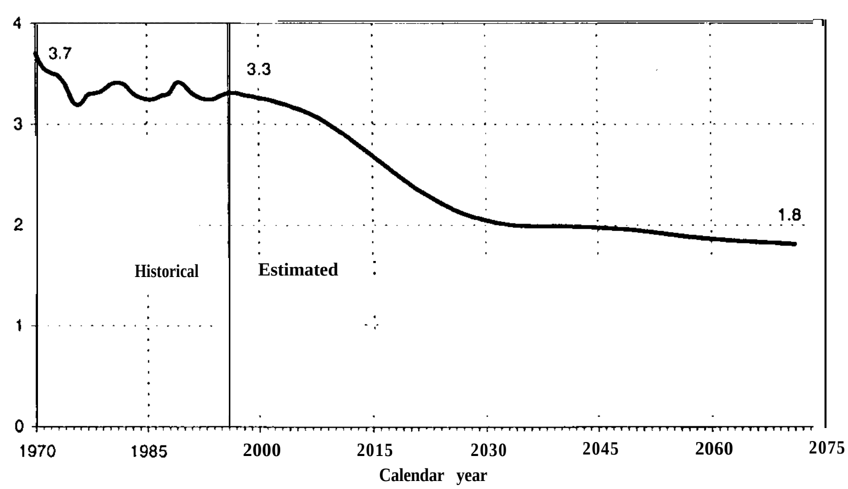



Chart 4.—Number of workers per OASDI beneficiary




75-year valuation period. The actuarial balance of a fund is the difference between annual income and costs, expressed as a percentage of taxable payroll, summarized over the 75-year projection period. The OASI, DI, and HI Trust Funds each have an actuarial deficit under the intermediate assumptions, as shown below. These actuarial deficit amounts can be interpreted as the percentage that would have to be added to the current law income rate in each of the next 75 years, or subtracted from the cost rate in each year, to bring the funds into actuarial balance. The actuarial deficit (as a percent of taxable payroll) for the trust funds is as follows:

| Program | Percent |
|---|---|
| OASI | 1.84 |
| DI | .39 |
| OASDI | 2.23 |
| HI | 4.32 |

## *Key Dates in Long-Range OASI and DI Financing*

For the next 15 years, annual income to the OASI and DI Trust Funds is projected, under the intermediate assumptions, to exceed outgo. As the baby boom generation reaches retirement age over the period from 2010 to 2030, several important points will occur, as shown below:

20 12—First year OASDI outgo exceeds tax income;

20 15—Year DI Trust Fund assets are exhausted;

20 19—First year OASDI outgo exceeds tax plus interest income;

2029—Year combined OASDI Trust Funds' assets are exhausted;

203 I-Year OASI Trust Fund assets are exhausted.

These key dates are the same as those shown in the 1996 report.

Exhaustion of a trust fund means that its accumulated assets are depleted. Payroll tax and other income will continue to flow into the fund, however. For example, in 203 1, tax income to the OASI fund is estimated to be sufficient to pay about three-fourths of program costs; that ratio is projected to decline to about two-thirds by the end of the projection period.

Before a trust fund is exhausted, the cash flow of the fund changes in stages. When combined OASDI expenditures exceed current tax income beginning in 2012, OASDI current tax income plus a portion of annual interest income will be needed to meet expenditures in 2012 through 2018. Beginning in 2019 and continuing through exhaustion of the combined OASDI trust funds in 2029, current tax income, annual interest income, plus a portion of the principal balance in the trust funds will be needed to pay benefits.

As noted earlier, the future cannot be predicted with certainty, and three sets of assumptions are used to project the range of possibilities. The year in which the trust funds are projected to be exhausted varies significantly under the three sets of assumptions (table 4).

## *The Size of Social Security and Medicare Compared With the Whole Economy*

An additional way to view the outlook for the trust funds is in relation to the economy as a whole. Table 5 shows the estimated outgo from each trust fund as a percentage of estimated gross domestic product (GDP) from 1997 to 2071.

Chart 5 shows in graphic form the growth in the outgo as a percentage of GDP. OASI and DI outgo increase by the same percentage over the full long-range period, while the increases in HI and SMI outgo are much larger. Shortly after 2020, Medicare spending for health care is projected to exceed Social Security spending for retirement, survivors, and disability benefits.

## *Conclusions*

Based on the Trustees' best estimates (alternative II): The Hospital Insurance (HI) Trust Fund, which pays inpatient hospital expenses, will be able to pay benefits for only about 4 years and is severely out of financial balance in the long range. The Trustees urge enactment of legislation this year to further control HI program costs and thereby extend the life of the HI Trust Fund. Such legislation, however, would represent only a modest first step toward achieving long-range balance between HI costs and funding. To facilitate long-term reform, the Trustees recommend the establishment of a national advisory group to examine the Medicare program. The advisory group would develop recommendations for effective solutions to the long-term financing problem. The Trustees believe that solutions can and must be found to restore and maintain the financial integrity of the HI program in both the short term and the long term.

The Supplementary Medical Insurance (SMI) Trust Fund, which pays doctor bills and other outpatient expenses, is financed on a year-by-year basis and trust fund income is projected to equal expenditures for all future years, but only because beneficiary premiums and Government general revenue contributions are automatically set to meet expected costs each year. The Trustees urge the Congress to take additional actions designed to control SMI costs in the near term. For the longer term, legislative proposals to address the large increases in SMI costs associated with the baby boomers' retirement should be developed through the same process used to address HI cost increases caused by the aging of the baby boomers. The Trustees believe that prompt, effective, and decisive action is necessary.

The OASI Trust Fund is expected to be able to pay benefits for about the next 34 years. At that time, annual tax income is projected to cover the cost of only about three-fourths of benefits payable. The Board believes that the long-range deficit of the OASI Trust Fund should be addressed in a timely way. It recommends that the proposals in the recent Advisory Council Report and others being advanced by public officials and private organizations should be carefully evaluated by the Government and the public. While we continue to believe that there is time to discuss and evaluate alternative solutions with deliberation and care, we also recognize that the impact of any required changes will be less disruptive the sooner they are enacted.

The Disability Insurance (DI) Trust Fund, which pays disability benefits, is projected to be exhausted in 2015. The Board believes that the experience of the DI fund should be closely monitored and the long-range deficit of the DI Trust Fund addressed.

Table 4.-Year of trust fund exhaustion

| Set of assumptions | OASI | DI | OASDI | HI |
|---|---|---|---|---|
| Alternative I (low cost) ................. | Never | Never | Never | 2002 |
| Alternative II (best estimate)........ | 2031 | 2015 | 2029 | 2001 |
| Alternative III (high cost) . . . . . . . . . | 2022 | 2007 | 2018 | 2000 |

Table 5.—Trust fund outgo as a percent of gross domestic product

| Trust fund | 1997 | 2020 | 2045 | 2071 | Percent increase |
|---|---|---|---|---|---|
| OASI...................... | 4.04 | 4.92 | 5.60 | 5.80 | 44 |
| DI.......................... | .61 | .88 | .90 | .88 | 44 |
| HI.. . . . . | 1.76 | 3.18 | 4.59 | 4.98 | 183 |
| SMI........................ | .97 | 2.54 | 3.20 | 3.42 | 253 |

## *A Message from the Public Trustees*[1]

*This is the second set of Trustees Reports in which we have participated since we began 4-year terms as Public Trustees on July 20, 1995. Our goal as Public Trustees is to ensure the integrity of the process by which these Reports are prepared and the credibility of the information they contain. We are honored that the President and the Senate have entrusted us with this responsibility. Further, although we are* **of** *different political parties, we approach our work as Public Trustees on a bipartisan basis because we strongly believe that this is the only way through which financial problems facing Medicare* *and Social Security can be solved. It is in this vein that we offer the following observations regarding the 1997 Annual Reports.*

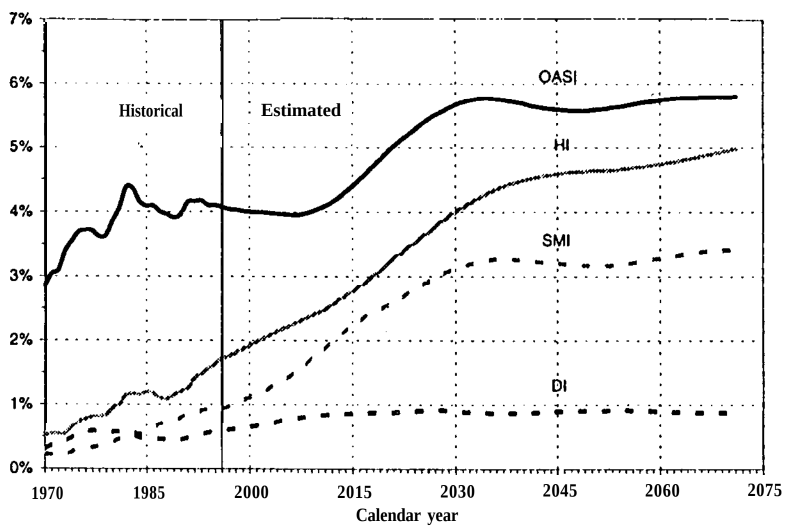
## *Informed Debate Is Needed*

*This year may finally mark the beginning of serious consideration of the future of Medicare and Social Security. The publication of the Social Security Advisory Council's report offering three very different approaches to the long-run financing problem facing Social Security has brought increased attention to that program, although it also illustrates that we have a long way to go before reaching consensus on a solution. The debate thus far on Medicare's future has focused on the need to achieve short-run savings to extend the life of the HI Trust Fund beyond 2001. But even this discussion has directed some attention to the longer run problems facing Medicare after 2010 as a result of the aging of the baby boom generation.*

*We welcome these discussions and hope that the trust fund reports and this Summary contribute to the factual basis necessary for an informed debate. The numbers contained in these reports are sobering, but their magnitude should not cause us to choose inaction as the appropriate response. Indeed, Americans need to become actively engaged in the debate about changes in these programs because the choices we make (or fail to make) in the next few years will carry important consequences for all of us. The aging of the baby boom generation will place heavy demands on both Social Security and Medicare, requiring substantial changes and sacrifices by some or all Americans.*

*A key point to remember as the debates go forward is that while Social Security and Medicare are large and complicatedprograms which are usually considered separately, they are clearly interrelated. Together, these programs form the foundation that Americans depend upon in retirement; both are vying for the same limited resources, and in the long run the shape of both programs will be driven by the same demographic forces that are leading us to an aging society.*

Chart 5.—OASI, DI, HI, and SMI cost as a percentage of GDP




## *Medicare*

*A major focus of issues facing Medicare is the imminent exhaustion of the HI Trust Fund. Under the intermediate (best estimate) assumptions in the 1997 Annual Reports, the fund will be depleted in early 2001—only 4 years from now. Legislative changes should be made this year since most proposals for slowing the growth in spending have their greatest impact only after several years. Even so, changes enacted this year to slow Medicare's growth would achieve most of their savings in the year 2000 and beyond, dangerously close to when the HI Trust Fund will be exhausted. Further, starting in 1995, income to the HI Trust Fund has been less than expenditures, and the HI fund has been drawing on its assets to meet the shortfall. In every year that passes without change, we will have to consume more and more of the trustfund's assets to meet current needs.*

*But focusing so heavily on HI's immediate problem diverts our attention from SMI, which has grown more rapidly than HI over Medicare's history. These two parts of Medicare are financed very differently and as a consequence, they have separate trust funds. But in practice, HI and SMI are just two parts of one program, and over time there has been shifting of benefits between them. Also, the factors that are driving up the costs of each part of Medicare are the same-better but more expensive medical technology, more medical care per person, and an aging population. Continued SMI growth at current rates will ultimately lead to costs that exceed the capacity of the funding sources-Federal general revenues and beneficiary premiums-to provide benefits.*

*Thus, the need to act quickly on the financial problems facing HI should not lead us to ignore SMI. Like HI, SMI's growth is unsustainable over time. Therefore, Medicare legislation this year should include changes in SMI as well as in HI.*

*Another fact that should be recognized in the debate about changes in Medicare is that, as history shows, the program must adjust every few years to changes in health care technology, methods of delivery, and utilization. If we can say one thing that we think would be helpful in the public debate on Medicare financing, it is that there are no magic bullets for solving the problem of high rates of health care spending. Therefore, even major legislation this year cannot fully resolve the issues of health care cost growth. We should expect that further legislative action will be needed even before tackling the increase in Medicare costs that will occur when the baby boom generation begins to retire.*

*Addressing the long-run issues will be difficult and challenging under any circumstance. However, finding longer term solutions will be facilitated if we* *can improve the current Medicare program, find legitimate short-run savings, and improve the balance between the traditional program and private plan offerings under Medicare. These short-run challenges will likely demand continuing vigilance and legislation over the next decade.*

*Do the challenges facing Medicare mean that it cannot be continued? No! But Medicare cannot stay exactly as it is, and it is misleading to think that any part of the program-beneficiary premiums, provider payments, controls on utilization, covered services, or revenues-can be exempt from change.*

## Social Security

*The cash benefits programs (OASI and DI) face longer-term challenges. The aging of the baby boom generation will also increase OASI expenditures, but OASI annual income, including interest, will exceed outgo for almost 25 years. Thus, the financing deficits facing OASI are smaller andfurther into the future than those facing either HI or SMI. Immediate changes in OASI are not necessary and the magnitude of the program changes that will eventually be needed will be less than those requiredfor HI and SMI.*

*Action should be taken soon, however, for several reasons. First, the earlier changes are implemented the more incremental they can be. Second, implementing changes soon would permit time for phasing them in and for workers to adjust their retirement plans. Third, there has been an alarming erosion of public confidence in the Social Security system over the past few years, particularly among younger generations. Early attention to Social Security's longer range financing problems is vital to restoring public confidence in the program.*

*The Advisory Council on Social Security has put forth three different approaches to deal with the long-run financing problem in OASI. Those and other plans deserve serious discussion now, so that reform legislation can be developed in the next few years that can gain the support of the American public. Some of these proposals would introduce fundamentally new concepts into the system, such as investment of the trust fund in common stock or the creation of individual accounts. Such proposals represent a profound shift in philosophy and would have significant ramifications. These ramifications deserve careful examination and consideration by policymakers and the American public before any changes are made.*

*Even in OASI, however, it should be possible to begin making adjustments to pave the way for longer run solutions. For example, improvements in the CPI to provide a more accurate measure of the cost of living should be actively sought and adopted for calculating Social Security annual cost-of-living adjustments. The future of the program requires not only that we make changes as soon as possible, but also that we demonstrate to younger Americans a commitment to a viable retirement system that they can be assured will serve them in the future.*

*The DI Trust Fundfaces other challenges. After significant increases in DI costs in the early 1990s, experience from I994 through 1996 shows that applications for DI leveled off during this period. However, the DI program has, throughout its history, experienced periods of growth and decline for which causes cannot be established with any precision. Consequently, the DI fund should be carefully monitored and its experience assessed in developing legislation to close the deficit projected in the DI fund in the decades ahead.*

## Conclusion

*We are privileged to take part in the thorough and careful process by which the Annual Reports are prepared to provide this vital public accounting. We strongly believe that these reports serve as an early warning of the need for changes to ensure continuation of these programs and* not *as evidence of their failure to protect future generations. Working cooperatively with informed public debate, we believe solutions can be found to the financing problems facing America as our population ages, and it is in this spirit that we will pursue further efforts at public education on Social Security and Medicare issues during our terms as Public Trustees.*